

FINANCIAL MARKETS

WHAT NOW FOR BREXIT?



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THE BREXIT SAGA CONTINUES

FOREWORD

The ongoing Brexit saga has taken another dramatic twist.

Prime Minister Theresa May's proposed Withdrawal Agreement has been rejected by the British parliament, leaving Brexit in uncertainty.

So what comes next? The purpose of this eBook is to analyse the possibilities while exploring what the financial markets favour.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

MAY'S DEAL IS A DODO

AN HISTORIC DEFEAT

On Tuesday 15th January 2019, the proposed Withdrawal Agreement that Prime Minister May negotiated across two years was rejected by parliament.

The deal was defeated by 432 votes to 202, in an overwhelming defeat for the British government. In fact, it's the biggest defeat of any government in history.

But the defeat was hardly a surprise. For several weeks MPs have made it clear to Prime Minister May that her proposed Withdrawal Agreement is unacceptable.

Specifically, hardline Brexiteers object to the Irish backstop provision. This is the insurance policy to ensure there is no hard border between Ireland and Northern Ireland.

If it came into effect, the Irish backstop would see the UK enter a

single customs territory with the EU. Northern Ireland would also have to adhere to some of the EU's single market rules.

But here's the problem. To exit the Irish backstop, the UK would need to strike an agreement with the EU.

Ultimately, this has proven unacceptable to Brexiteer MPs, as they believe this arrangement gives the EU too much control.

Meanwhile, MPs that favour remaining inside the EU have seemingly exploited an opportunity to pressure Prime Minister May and push for a softer Brexit.

REACTION OF THE MARKETS

Interestingly, after the result of the vote was confirmed, the pound sterling ticked upwards against the US dollar, rising to \$1.2787 and making up for the day's earlier decline. At the time of writing, the pound is pushing \$1.30 against the US dollar.

The reason why is clear. The market interpreted parliament's rejection of the Withdrawal Agreement as increasing the chances of a softer Brexit, or even Brexit being delayed or stopped. Remember - parliamentary arithmetic suggests that there could be a majority for a Brexit which includes a customs union with the EU, or at least closer regulatory alignment.

Keep in mind that the financial markets favour the UK keeping close economic and trade ties with the EU. Generally, business and investors are nervous that an abrupt Brexit could disrupt trade and supply chains.

Of course, a softer/delayed Brexit (or no Brexit at all) is a possibility now that Prime Minister May's deal has been rejected. However, this is also true of a 'No Deal' Brexit - which is currently the default position as we head towards Friday 29th March 2019.

MAY SURVIVES NO CONFIDENCE VOTE

Clearly, a government defeat of this magnitude has political consequences. Following the result of the vote, the leader of the government's opposition (Labour), Jeremy Corbyn, called for a general election and submitted a motion of 'No Confidence' in the Conservative government.

However, this motion was also rejected by parliament. A total of 326 MPs voted against the motion, while 305 voted for it - taking a general election off the table.

WHAT HAPPENS NEXT?

After surviving the motion of 'No Confidence', Prime Minister May reached out to the leaders of other political parties and senior parliamentarians.

She urged them to meet with her in an effort to find a workable Brexit deal that could command a majority in the House of Commons.

At the time of writing, those talks are ongoing. Truthfully, it's anyone's guess as to what, if anything, will be agreed in these negotiations. Brexit is a complex issue that splits traditional party lines - and finding consensus is difficult.

WILL THE RED LINES BE ABANDONED?

The real question is whether Prime Minister May will be prepared to move on any of her red lines. Remember - she believes these red lines are critical, as they deliver (in her view) the Brexit that the people voted for.

Her red lines include:

- **Controlling British borders and protecting the integrity of the United Kingdom.**
- **Leaving the single market to end freedom of movement and control immigration levels.**
- **Leaving the customs union so that Britain can determine its own trade policy.**
- **Ending significant payments to the EU budget.**

It's thought that a majority of MPs in parliament would favour a deal that secured a permanent customs union with the EU. But here's the issue - a permanent customs union would likely require the UK to follow EU trade rules, without being able to influence them.

Plus, it's likely that such a deal would require the UK to apply the EU's common tariff to non-EU countries. This would limit the UK's ability to negotiate its' own free trade deal agreements.

WHAT ABOUT A NO DEAL BREXIT?

The majority of MPs also want to government to rule out a 'No Deal' Brexit - something which Prime Minister May has said is

'impossible' to do.

Technically, the Prime Minister is correct. She cannot rule out a 'No Deal' scenario as it is the default legal position of the UK come Friday 29th March 2019.

The only way to avoid a 'No Deal' scenario would be for parliament to vote through a Withdrawal Agreement, or for the UK to revoke Article 50. The latter point is politically contentious, as it essentially stops Brexit.

AN EXTENSION TO ARTICLE 50 LIKELY

With Friday 29th March 2019 fast approaching, the pressure is on the British parliament to now work with the UK government and propose a workable alternative.

But keep in mind, if the UK government and parliament do manage to reach a compromise, it isn't the end of the issue. All 27 EU member states would also need to agree to a newly proposed deal. It's why some British politicians favour extending Article 50 beyond the current Friday 29th March 2019 deadline.

Extending Article 50 is possible - but that too requires the approval of all 27 EU member states. However, there is resistance to this idea - as European elections are set to take place in May 2019.

ANOTHER REFERENDUM?

If the British parliament fails to reach a compromise, running a referendum on how to proceed with Brexit is an option. The British

press report that some government cabinet ministers believe that a referendum is needed.

It's not clear what questions a second referendum would include. However, the People's Vote campaign (which supports another referendum), states that the referendum would likely present three options: 'No Deal', 'Deal', or 'Stay in the EU'.

WHAT TO WATCH FOR

The pound sterling will likely strengthen if there are signs that the UK government and parliament reach a compromise on a deal. In this situation, it's likely that the compromise will 'soften' Brexit beyond Prime Minister May's original deal, as that's where the majority lies in the House of Commons.

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